Punitive Damages in Commercial Contract Arbitration — Still an Issue After All These Years

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I. INTRODUCTION

If arbitration is to remain a viable and desirable alternative to litigation, legislatures and the American Arbitration Association must address the role of punitive damages in commercial arbitration. Courts and commentators alike are divided in their approach to this issue, and this lack of uniformity recently reared its head. A recent Massachusetts Superior Court decision, *Total Property Services of New England v. Lockwood-McKinnon Co., Inc.*,[1] held that an arbitrator could not award punitive damages and reversed the award. This result highlights the ongoing debate about the propriety and desirability of punitive damages in arbitration. Although this decision was extremely narrow, the case provides an excellent vehicle for exploring the merits of arguments on both sides of the issue. This Article first analyzes *Total Property* and argues that under Massachusetts law, the court's holding was incorrect. Second, after reviewing the principal cases and articles dealing with punitive damages in arbitration, this Article argues that those addressing this area in the past failed to adequately consider both sides of the issue. Finally, this Article suggests a compromise that would resolve some of the complex, competing considerations on both sides and calls upon the American Arbitration Association to implement it.

II. *TOTAL PROPERTY*: THE CASE

During the construction of a number of restaurants in Massachusetts, several disputes arose between the general contractor and the owners.[2] Pursuant to a standard American Arbitration Association (AAA) clause, the parties submitted their claims to arbitration.[3] The arbitrator awarded

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[1] No. 91-949, slip op. (Sup. Ct. Mass. Feb. 27, 1992).

[2] *Id.* at 2. There are few reported facts as the original proceeding was heard before an arbitrator.

[3] *Id.* The standard clause provides: "Any controversy or claim arising out of or relating to this contract, or breach therof, shall be settled by arbitration in accordance with the Construction Industry Arbitration Association (AAA), and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof." AAA CONSTRUCTION INDUSTRY ARBITRATION RULES as amended and in effect, 1/1/91.

multiple damages and attorneys' fees against the general contractor, and the general contractor appealed.[4] Despite the traditional statutorily-mandated narrow scope of review for arbitration awards,[5] the judge vacated the award on the ground that the arbitrator had exceeded his authority by awarding multiple damages.[6]

A. Holding and Analysis

Because Massachusetts only allows the award of multiple or punitive damages pursuant to a statute,[7] the court looked at Chapter 93A, of the Consumer Protection Act and assumed that the arbitrator's award was based on the multiple damage and attorneys' fee provisions of that statute.[8] The court looked at a specific clause in 93A which provides that "the amount of actual damages to be multiplied by the court shall be the amount of the *judgment* on all claims arising out of the same or underlying transaction or occurrence. . . ."[9] The court held that an arbitrator's award did not constitute a "judgment" within the meaning of 93A, and thus multiple

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[4] *Total Property*, No. 91-949, slip op. at 2.

[5] *Id.* at 2.

[6] *Id.* at 5-6. Awarding attorneys' fees in arbitration violates MASS. GEN. LAW ANN. ch. 251, §10 (1992), the Massachusetts Uniform Arbitration Act.

[7] *See, e.g.*, Stone v. Essex County Newspapers, Inc., 330 N.E.2d 161, 169 (1975).

[8] *Total Property*, No. 91-949, slip op. at 5. *See generally* MASS. GEN. LAWS ANN. ch. 93A (1994) (demonstrating that, since 1969, 93A, the Consumer Protection Act, is effectively Massachusetts' most powerful general business statute); G. Richard Shell, *The Power to Punish: The Authority of Arbitrators to Award Multiple Damages and Attorney's Fees*, 1987 MASS. L. REV. 26, 27 (1987) [hereinafter Shell, *Power to Punish*] (arguing that a defendant's liability for multiple damages is tied to the degree of his culpability); International Fidelity Ins. Co. v. Wilson, 443 N.E.2d 1308, 1316 (Mass. 1983) (showing that the multiple damage provisions of 93A are clearly punitive in nature and stating that the statute's twin goals are the deterrence of unfair or deceptive conduct and the discouragement of vindictive lawsuits; although 93A is consumer oriented, section 11 makes it applicable in a commercial and business context); Joanne M. D'Alcomo, Note, *Resolving the Conflict Between Arbitration Clauses and Claims Under Unfair and Deceptive Practices Acts*, 64 B.U. L. Rev. 377 (1984) (tracing consumer protection or unfair and deceptive practices (UDAP) statutes adopted by most states in the 1960s and 1970s and asserting that a common feature of these statutes is that they often provide for attorney's fees and multiple or punitive damages).

[9] *Total Property*, No. 91-949 at 6 (citing MASS. GEN. LAWS ANN. ch. 93A, § 9 (1994) (empahsis added)). In normal litigation, the judge or jury would establish the amount of actual damages as a matter of fact, and the judge would double or treble the amount, in proportion to the nature of the unfair or deceptive conduct.

damages were precluded.[10]

Although the court noted that punitive damages are routinely awarded by arbitrators and confirmed by courts under the Federal Arbitration Act, it stated that Massachusetts law, under 93A, mandated a contrary result.[11] The court mentioned that it was "not unmindful of the potential 'chilling effect' this decision may have on commercial arbitration, especially in light of strong public policy favoring arbitration as an alternative means of dispute resolution."[12] The court simply concluded that "the parties will have to trade off expediency [of arbitration] for multiple damages."[13] Taken one step further, this holding indicates that by including an arbitration clause in a contract, plaintiffs effectively waive recovery of, and defendants shield themselves from, punitive damages under Chapter 93A.

The court suggested that amending 93A by changing the language to "judgment or arbitrator's award" would change this result. Although this legislative change would remedy the statutory conflict discovered by the court, it avoids the underlying issue. The holding was obviously quite narrow. The court chose to focus on, or create, a statutory construction question instead of focusing on the primary conflict — the appropriateness of awarding punitive damages in arbitration. Regardless of the narrow holding, the case arguably conflicts with Massachusetts' precedent.

B. Waivers of 93A and Arbitration: Total Property *May Be Wrong*

There are two arguments that indicate that *Total Property* was not properly decided. First, based on the *Total Property* result, anyone who signs a contract containing an arbitration clause and later submits the dispute to arbitration in fact waives the possibility of punitive damages under Chapter 93A.[14] This is contrary to prior Massachusetts law. Second, the Supreme Judicial Court addressed the issue of arbitration of claims involving Chapter 93A and seemed to hold that these disputes are arbitrable.

In *Canal Electric Co. v. Westinghouse Electric Co.*[15] the Supreme Judicial Court of Massachusetts addressed the question of whether a party could waive the right to a 93A claim. The court stated that a statutory right may not be disclaimed if "the . . . waiver would do violence to the public

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[10] *Total Property*, No. 91-949 at 6.

[11] *Id.*

[12] *Id.* at 6 n.5.

[13] *Id.*

[14] *Id.* ("[I]t appears parties will have to trade off [the] expediency [of arbitration] for multiple damages [under 93A].").

[15] Canal Elec. Co. v. Westinghouse Elec. Corp., 548 N.E.2d 182, 188 (Mass. 1990).

policy underlying the legislative enactment."[16] The court held that where the waiver was a purely private transaction between business parties, and the 93A claim was merely duplicative of a claim in contract, it was not against public policy to sustain the waiver.[17] In *Total Property,* although the facts are unknown, the arbitral award of multiple damages indicates the presence of tortious conduct as well as breach of contract. Under the *Total Property* holding, arbitration clauses effectively waive 93A claims. This conflicts with the *Canal Electric* rule that 93A claims are generally not waivable. The court's pronouncement in *Total Property* that parties in arbitration must forgo multiple damage claims, is thus contrary to precedent.[18]

In another case, *Greenleaf Engineering & Construction v. Teradyne, Inc.*,[19] the Massachusetts Appeals Court considered an appeal from an order staying litigation of a 93A claim until the completion of arbitration. The court held that where private parties agree to arbitrate a dispute that is private in nature, litigation involving 93A can be stayed pending arbitration.[20] In other words, private commercial disputes that involve 93A claims could arguably be arbitrated. Although the *Greenleaf* court did not directly address the arbitrability of the 93A claim, other cases allowing punitive damage issues to go to arbitration cite *Greenleaf* for this proposition.[21] The *Total Property* court did not cite *Greenleaf.*

Thus, under *Canal Electric,* 93A claims are generally not waivable, and under *Greenleaf* these claims are arbitrable. Although the result in *Total Property* may be technically correct under strict statutory interpretation, it is not supported by precedent.

C. Conclusion

The *Total Property* opinion avoided an in-depth analysis of the propriety of punitive damages in arbitration. This is not surprising in light of the lack of consensus on the issue. Federal courts generally approve of allowing arbitrators to award punitive damages, while some state courts do not. Either way, the *Total Property* holding effectively emasculates the

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[16] *Canal Electric,* 548 N.E.2d at 188 (quoting Spence v. Reeder, 416 N.E.2d 914, 924 (Mass. 1981)).

[17] *Canal Electric,* 548 N.E.2d at 188.

[18] *Total Property,* No. 91-949, slip op. at 6 n.5.

[19] 447 N.E.2d 9 (Mass. App. Ct. 1983).

[20] *Id.* at 12.

[21] *See* Rodgers Builders, Inc. v. McQueen, 331 S.E.2d 726, 732 (N.C. Ct. App. 1985) (citing *Greenleaf* as a case that "declined to exclude similar [punitive damage] claims from arbitration."). See *infra* note 63 and accompanying text for an extensive analysis of *Rodgers.*

goals of two statutes. First, in any Massachusetts contract action, plaintiffs who sign a contract containing an arbitration clause will be unable or less likely to pursue a punitive remedy, even in the face of clearly fraudulent conduct. As a consequence, the deterrent effect of Chapter 93A is minimized. In addition, by offering or signing a contract that contains an arbitration clause, a potential defendant frees himself to act in an "unfair or deceptive" manner without the fear of a multiple damage or attorney fee award. Second, the effectiveness of arbitration as a realistic alternative to litigation is infringed. Aggrieved consumers or plaintiffs must now turn to litigation if they wish to pursue a Chapter 93A remedy, unless, of course, they are bound by an arbitration clause.

Although much has been written on the subject, in the light of the narrow and confused holding of *Total Property*, the punitive damages issue merits further review. In the following sections, this Article will present a background to arbitration, approaches to both sides of the issue, critiques of those approaches, and finally, a suggested solution that may satisfy everyone.

III. BACKGROUND TO ARBITRATION

A. Arbitration: Definitions, History, and Advantages

The most popular definition of arbitration is that it "is a process whereby parties voluntarily submit their disputes for resolution by one or more impartial third persons, not by a judicial tribunal provided by law."[22] Arbitration is not a recent innovation and has been an alternative to litigation for several hundred years.[23] In the United States, as early as 1855, the Supreme Court addressed arbitration's origins in freedom of choice and the advantages of its finality.[24] In 1925, Congress enacted the Federal

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[22] Thomas J. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 425 n.1 (1988) [hereinafter Stipanowich, *Rethinking*] (citing MARTIN DOMKE, COMMERCIAL ARBITRATION §1.01, at 1 (G. Wilner ed. 1984)).

[23] STEPHEN GOLDBERG ET AL., DISPUTE RESOLUTION 199 (2d ed. 1992) (explaining that arbitration was used before the fourteenth century and clearly predated the American Revolution).

[24] As a mode of settling disputes, [arbitration] should receive every encouragement from courts of equity. If the award is within the submission, . . . contains the honest decision of the arbitrators, after a full and fair hearing . . . a court of equity will not set it aside for error, either in law or in fact. A contrary course would be a substitution of the judgment of the chancellor in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation.

Burchell v. Marsh, 58 U.S. 344, 349 (1854).

Arbitration Act,[25] and in recent years, the Supreme Court has continued the expansion of arbitration's scope by liberally construing arbitration clauses.[26] Under the Federal Arbitration Act and the individual states' Uniform Arbitration Acts, arbitration is a viable and legislatively recognized alternative to litigation.

Arbitration's many advantages over litigation include the expertise of the decisionmaker, the finality of the decision, the privacy of the proceedings, the procedural informality, and the low cost and speed of the process.[27] Thus, arbitration avoids many of the shortcomings of the American judicial process. As one author notes:

> The modern judicial process is characterized by high cost, excessive formality, and long delays. Having gone to the time and trouble of bringing a case through interminable pretrial motion practice, attempting to educate the decision maker while observing the intricacies of the trial procedure, and waiting out a lengthy appeal, even a 'victorious' litigant may well question whether justice has been served.[28]

The benefits of arbitration are thus well recognized and receive both judicial and legislative encouragement.

B. The Uniform and Federal Arbitration Acts

Most states enacted some version of the Uniform Arbitration Act (UAA).[29] The Act legislatively validates contractual arbitration clauses and clearly defines the relationship between the arbitration process and the judiciary.[30] Among other things, the statute provides for court confirmation

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[25] 9 U.S.C. §§ 1-15 (West 1970).

[26] Douglas Davis, Note, *Overextension of Arbitral Authority: Punitive Damages and Issues of Arbitrability*—Raytheon Co. v. Automated Business Systems, 65 WASH. L. REV. 695, 698 (1990); *see also* Stipanowich, *Rethinking*, *supra* note 22, at 426.

[27] GOLDBERG ET AL., *supra* note 23, at 200; Stipanowich, *Rethinking*, *supra* note 22, at 433; Margaret Sullivan, Comment, *The Scope of Modern Arbitral Awards*, 62 TUL. L. REV. 1113, 1114 (1988).

[28] Stipanowich, *Rethinking*, *supra* note 22, at 428.

[29] *See, e.g.*, MASS. GEN. LAWS ANN. ch. 251 (1992). This version, similar to that in other states, has been in effect since 1960.

[30] *Id.* Stating that "a written agreement" to submit to arbitration is "valid, enforceable and irrevocable," except on other grounds for contract revocation (§ 1); provides for the fees and expenses of arbitration (§ 10); grants due process guarantees, including "the right to be heard, to present evidence . . . and to cross-examine witnesses appearing at the hearing"(§ 5(a)); and provides the right to be represented by an attorney (§ 6).

of the arbitration award and the extremely limited grounds for its reversal or modification.[31] The grounds for reversal are limited to situations where the award was "procured by corruption, fraud or other undue means," where there was evident partiality by the arbitrator or where the arbitrator exceeded his powers.[32] A court will modify the award only if there was an evident miscalculation or misidentification, the arbitrator exceeded his authority, and changing the award would not affect the merits of the rest of the decision.[33] Courts generally turn to the section regarding arbitral authority when addressing punitive damage issues.

On the federal level, there is the Federal Arbitration Act (FAA)[34] which governs interstate, foreign and maritime commerce, and is enforceable in both state and federal courts. A state court enforcing an agreement or arbitration award under the FAA must apply federal substantive arbitration law,[35] notwithstanding state law to the contrary.[36] The federal approach to arbitration is extremely broad, and most questions, including the award of punitive damages, are resolved in favor of expanding the scope of arbitration and arbitral power.[37]

C. Perceived Disadvantages

The perceived disadvantages of arbitration, considered in greater detail in the second part of this Article, are mainly procedural in nature. Arbitrators are not required to make any written findings, and can simply award a lump sum. Further, although arbitrators may consider substantive law, mistakes of law are generally not grounds for reversal. Mistakes of fact are also not grounds for review. The rules of evidence do not apply, nor do the rules of procedure or discovery. Although the arbitrator may subpoena witnesses, generally the parties cannot. It is through these stringent limitations on review and procedure that arbitration achieves its goals of efficiency and finality. As we will see, these same limitations raise serious

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[31] MASS. GEN. LAWS ANN. ch. 251, §§ 11-13 (1992).

[32] *Id.* § 12.

[33] *Id.* § 13.

[34] 9 U.S.C. §§ 1-15.

[35] Shell, *Power to Punish*, *supra* note 8, at 26 n.3. A recent Supreme Court decision "created a body of federal substantive law applicable to any agreement within the coverage of the FAA." Davis, *supra* note 26, at 698 (citing Moses H. Cone Memorial Hosp. v. Mercury Corp., 460 U.S. 1 (1983)).

[36] Stipanowich, *Rethinking*, *supra* note 22, at 427 n.3 (citations omitted).

[37] Davis, *supra* note 26, at 699. There is, however, some evidence of a split in authority regarding punitive damages in some types of arbitration, but it is beyond the scope of this Article.

difficulties with the award of punitive damages in arbitration.

D. Conclusion

Given the legislative and judicial support of arbitration, and the expensive and time-consuming alternative of litigation, it is not surprising that arbitration has increased over 250% from 1972 through 1986.[38] The strong policy favoring arbitration insulates most awards from review or modification with the notable exception of punitive damage awards in arbitration. Armed with the example of *Total Property* and the background information on arbitration, this Article now turns to the cases and comments on punitive damage awards in arbitration. The American judiciary and its scholars are equally divided on the issue. This Article will first explore some of the cases and commentaries which argue that arbitrators should be allowed to award punitive damages and then discuss those that argue that arbitrators should not.

IV. IN FAVOR OF ALLOWING PUNITIVE DAMAGES IN ARBITRATION

A. Raytheon[39] *and the Federal Arbitration Act*

In *Raytheon v. Automated Business Systems*,[40] the First Circuit Court of Appeals affirmed an arbitrator's award of punitive damages.[41] On appeal, Raytheon raised several arguments.[42] Most relevant here is the central issue,

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[38] Ira Rothken, Comment, *Punitive Damages in Commercial Arbitration: A Due Process Analysis*, 21 GOLDEN GATE U. L. REV. 387 n.1 (1991). For an analysis of the current state of arbitration, see generally Stipanowich, *Rethinking*, *supra* note 22.

[39] Raytheon v. Automated Business Sys., 882 F.2d 6 (1st Cir. 1989).

[40] *Id.* A panel of arbitrators awarded compensatory damages, attorney's fees, and $250,000 in punitive damages.

[41] *Id.* The District Court affirmed the entire award. On appeal, Raytheon sought to vacate only the punitive portion.

[42] *Id.* Raytheon argued that the arbitrators made no findings of fact. The court stated that arbitrators are not required to make findings of fact. *Id.* at 8 (citations omitted). The court noted that arbitrators can just award a lump sum "without disclosing their rationale for it." *Raytheon*, 882 F.2d at 8 (citations omitted). In addition, Raytheon argued that it was deprived of its Fifth Amendment due process rights because the arbitrators failed to notify Raytheon that they intended to address the issue of punitive damages. *Id.* The court dismissed these arguments on two grounds. First, this argument was not supported by relevant events: Raytheon had waited until the day the hearings started before raising the issue of punitive damages and "buried its one sentence treatment of the issue in a 34-page memorandum." *Id.* The court also stated that this argument was not supported by precedent; it distinguished the

"whether the arbitration clause in the contract . . . empowered the arbitral panel to award punitive damages."[43]

Sustaining the award, the court noted the FAA's broad policies, the breadth of the standard AAA contract clause, and the rule empowering arbitrators to "grant any remedy or relief which is just and equitable and within the terms of the agreement of the parties."[44] Also relevant to the court's decision was Raytheon's commercial sophistication and probable familiarity with the arbitration rules.[45] Raytheon cited two labor arbitration cases, including a First Circuit decision, where the court denied arbitrators the power to award punitive damages.[46] The court distinguished the two labor cases on the grounds that "[l]abor arbitration is an integral aspect of the entire collection of the bargaining process; it is intended to be a part of a continuing and ameliorating enterprise between parties who maintain an ongoing working relationship."[47] The court concluded that commercial arbitration, on the other hand, is normally seen as a "one-shot endeavor."[48] The court then discussed and rejected two possible approaches to the issue of punitive damages in arbitration. The court declined to follow a rule of prohibiting punitive damages in arbitration, describing it as too restrictive.[49] The court also rejected an approach followed by some courts which allows punitive damages to be "awarded by a commercial arbitrator only if the parties' agreement to arbitrate specifically provide[s] for [that] possibility."[50] The *Raytheon* court characterized this approach as "inconsistent with federal arbitration policy" and contrary to the weight of

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cases on which Raytheon relied as situations where the arbitrators were determined to be completely unfair. *Id.* at 9. *See* Due Process discussion, *infra* note 107 and accompanying text.

[43] *Raytheon*, 882 F.2d at 9.

[44] *Id.* at 10 n.4 (referring to AAA Rule 42).

[45] *Id.* at 9. This commercial sophistication clearly did not prepare Raytheon for the award of punitive damages. The AAA rules do not mention punitive damages, although, as will be argued at the end of this Note, they should. For a thorough criticism, see Davis, *supra* note 26.

[46] Bacardi Corp. v. Congreso de Uniones Industriales de Puerto Rico, 692 F.2d 210, 214 (1st Cir. 1982) (requiring authorization for an arbitrator to award punitive damages); Miller Brewing Co. v. Brewery Workers Local Union No. 9, 739 F.2d 1159, 1164 (7th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985).

[47] *Raytheon*, 882 F.2d at 10.

[48] *Id.*

[49] *Id.* at 11. For an extensive discussion of this approach in the discussion of the *Garrity* decision, see *infra* text part V.A.

[50] *Raytheon*, 882 F.2d at 11. The court cited Belko v. AVX Corp., 251 Cal. Rptr. 557, 562 (1988) for this proposition. The *Raytheon* court argued that it went against prior California precedent.

federal authority.[51] The *Raytheon* court chose to follow other federal circuits and held that arbitrators could award punitive damages. The *Raytheon* court, looking at the plaintiff's rights, concluded that "the fact that the parties agreed to resolve their dispute through an expedited and less formal procedure does not mean that they should . . . surrender a legitimate claim to damages."[52] The court also noted that parties wishing to exclude punitive damage awards from arbitration could do so by contract.[53]

Thus, the First Circuit chose a fairly "inclusive" approach to the arbitration clause – unless otherwise specified, punitive damages are within the scope of arbitration. This gives the benefit of the clause to the party seeking to recover punitive damages. Although this position upholds public policies favoring punitive damages, it raises serious due process questions, which are discussed later.

B. Approach: Punitive Damages Are of Social Importance

In his article, Richard Shell presents some of the arguments that support punitive damages in general.[54] These include compensating plaintiffs for legal costs, injured feelings, insult, and mental distress, punishing defendants "for injuries to society caused by flagrant abuse of accepted norms," and deterring potential wrongdoers.[55] Shell believes that the inherent value of these rationales justifies the award of punitive damages in arbitration.

One could argue, however, that because arbitrators issue no findings, the deterrence-of-potential-wrongdoers argument must fail. Until such time as arbitrator awards become part of the public record, the deterrent effect is certainly minimal. Shell addresses this difficulty by arguing that "it is possible that third parties in the defendant's industry will learn that a particular award has been made by word-of-mouth, through the trade press, or through published opinions resulting from judicial proceedings to vacate

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[51] *Raytheon*, 882 F.2d at 11.

[52] *Id.* at 12.

[53] *Id.*

[54] Shell, *Power to Punish*, *supra* note 8. He argues that arbitrators should be permitted to award damages under 93A. The article was written before the *Total Property* decision.

[55] *Id.* at 29 (quoting David A. Rice, *Exemplary Damages in Private Consumer Actions*, 55 IOWA L. REV. 307, 309 (1969)). Another argument is that "punitive damages provide an incentive . . . to pursue causes of action where tangible harm and resulting damages are nominal but where the defendant's behavior subjects society to substantial risks." Thomas Stipanowich, *Punitive Damages and Arbitration:* Garrity v. Lyle Stuart Inc. *Reconsidered*, 66 B.U. L. REV. 953 (1986) (citation omitted) [hereinafter Stipanowich, *Punitive Damages*].

or confirm the award."[56] This response is weak and detracts from his central premise. To be an effective deterrent, the punishment must be disseminated to as many defendants as possible. At the very least, attorneys should know that an award of punitive damages has been made. Since most arbitration awards go unpublished, the deterrent effect is practically nonexistent.

Shell argues that a rule barring multiple damage awards by arbitrators poses a danger to the arbitration system as a whole.[57] He points out that one of the UAA's strengths is its emphasis upon flexible remedial authority, and if punitive damages are barred, the arbitration forum could lose a measure of this flexibility.[58] Further, parties might be less likely to choose to invoke arbitration if they know that they will forgo important statutory remedies.[59]

Shell and others who support his position fail to address this issue from the defendant's perspective. Most defendants would not want the issue of punitive damages presented to an arbitrator who is not bound by substantive law, who is not required to prepare written findings, and from whose decision there is little room to appeal. There must be some protection offered to the defendant faced with large punitive damage awards.

Finally, Shell argues that most Unfair and Deceptive Practices (UDAP) statutes, like Chapter 93A, require the doubling or trebling of damages depending on the facts. Therefore, the damages are not arbitrarily punitive and are limited to a factor of the actual damages.[60] Further, he posits that courts will scrutinize multiple or punitive arbitration awards more closely than they would ordinary awards.[61] He notes that although this may hurt the finality aspect of arbitration, he believes that "[t]his marginal degree of increased scrutiny by the judiciary . . . is not likely to cause major inefficiencies in the arbitration process as a whole."[62] This approach does, however, involve greater judicial meddling in the arbitration process, with its related increase in both time and expense.

Raytheon, decided two years after Shell's article, indicates that courts give little scrutiny to the award. The *Raytheon* court paid little or no attention to the content of and basis for the punitive damage award. Although some of Shell's arguments based on the beneficial aspects of punitive damages are persuasive, the lack of attention to the defendants'

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[56] Shell, *Power to Punish*, *supra* note 8, at 34.

[57] *Id.* at 33.

[58] *Id.*

[59] *Id.*

[60] *Id.* Shell fails to address the legal rule that arbitrators need not delineate the basis of the award, nor are they constrained by substantive law. Therefore, a court may not know the basis for computing the award, as in *Total Property*.

[61] Shell, *Power to Punish*, *supra* note 8, at 35.*Id.* at 35.

[62] *Id.* at 34.

perspective undermines their validity. Arbitration is designed to benefit both parties, not just an aggrieved plaintiff.

C. *The* Rodgers[63] *Case: Minimizing Exceptions to Arbitration's Reviewability Can Also Hurt the Plaintiff*

In *Rodgers Builders, Inc. v. McQueen*, a North Carolina court held that an arbitrator can award punitive damages.[64] The plaintiff had filed a complaint, but the action was stayed pending arbitration.[65] After confirmation of the award, the plaintiff amended his court complaint to include fraud claims and $1 million in punitive damages.[66] The appeals court affirmed summary judgment for the defendant on the grounds that the amended claims were barred by the doctrine of *res judicata*.[67] The plaintiff argued that because the punitive damage claims were outside the scope of the arbitration agreement, *res judicata* did not apply[68]. The appeals court, emphasizing the strength of state policy favoring arbitration, held that all the claims, including those for punitive damages, were sufficiently related to the original contract to be arbitrable.[69] The plaintiff was thus effectively precluded from recovering punitive damages.

In a Comment on *Rodgers*, one author argues that courts essentially balance the imperativeness of the punitive damages policy against the advantages of arbitration.[70] Noting various exceptions to the rule against punitive damages and reviewability, the author argues that the public policy considerations that support exceptions to the arbitrability of punitive damages in areas such as collective bargaining, antitrust, child custody or support, do not apply in the commercial contract context.[71] The primary

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[63] Rodgers Builders, Inc. v. McQueen, 331 S.E.2d 726 (N.C. Ct. App. 1985).

[64] *Id.* at 734.

[65] *Id.* at 728.

[66] *Id.* at 729-30.

[67] *Id.* at 730. For a discussion of *res judicata* and arbitration, see generally Hiroshi Motomura, *Arbitration and Collateral Estoppel: Using Preclusion to Shape Procedural Choices*, 63 TUL. L. REV. 29 (1988); G. Richard Shell, *Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 UCLA L. REV. 623 (1988).

[68] *Rodgers*, 331 S.E.2d at 731.

[69] *Id.* at 730-34.

[70] Mitchell Benowitz, Comment, Rodgers Builders, Inc. v. McQueen: *Arbitration and Punitive Damages*, 64 N.C. L. REV. 1145, 1149 (1986) (citations omitted). This is an extremely persuasive argument for the notion that this area of the law — defining the scope of arbitration — has been and should continue to be a legislative function, not a judicial one.

[71] *Id.* at 1149-53.

reason for these exceptions "is that a private resolution of the dispute may adversely affect nonparticipating third parties, whose interests the courts must protect."[72] These parties include the public in antitrust cases or individuals in child custody disputes.[73] Commercial disputes, he argues, raise no such concerns, as the parties are on equal footing.

Although the *Rodgers* case involved a plaintiff's lost rights, the author's approach again neglects the defendant who has almost no recourse to the courts for correction of an overly large punitive damages award. The author notes that common arguments against punitive damages are the potential for abuse by arbitrators and the lack of a trial's procedural safeguards.[74] He argues that the premise that a punitive damage award may reflect prejudice rather than impartial judgment is equally applicable to a jury award.[75] He neglects to mention that in a jury trial, unlike in arbitration, the potential for prejudice, is neatly counterbalanced by its appealability.[76]

The Comment raises a number of other arguments in favor of allowing punitive damages in arbitration. First, in contrast to a trial court's relative inexperience, an arbitrator's expertise in a particular business enables her to determine whether certain commercial conduct warrants a punitive remedy.[77] Second, not allowing an arbitrator to award punitive damages creates the practical problem of having a separate trial for punitive damages while infringing on the arbitrator's discretion to fashion remedies.[78] Third, the threat of punitive damages would provide an effective means for an arbitrator to force compliance with any other remedy fashioned by the arbitrator.[79] In sum, the author concludes that the public policy favoring arbitration outweighs the difficulties of allowing punitive damages.[80]

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[72] Benowitz, *supra* note 70, at 1149.

[73] *Id.* (citations omitted).

[74] *Id.*

[75] *Id.* at 1152-53 (citations omitted).

[76] In addition, at least under 93A, it is the judge awarding punitive damages. *See* MASS. GEN. LAWS ANN. ch. 93A, §11 (1994).

[77] Benowitz, *supra* note 70, at 1153 (citation omitted). Why is a construction expert better than a court to determine if fraud or an unfair or deceptive act occurred? The standards for proving fraud or unfair or deceptive acts should not be unique to a specific industry. To create such a broad range of "standards" would grant arbitrators broad power and give parties so little guidance that the deterrent effect of punitive damages would be minimized.

[78] *Id.* (citation omitted).

[79] *Id.*

[80] *Id.* at 1156.

D. Freedom to Contract and Arbitral Flexibility

Another author[81] argues that maintaining an arbitrator's flexibility in fashioning remedies is the principal policy reason for allowing punitive damages in arbitration.[82] He states that the legislative decision to grant arbitrators considerable latitude and flexibility in fashioning remedies parallels the placement of limitations on judicial review of arbitrators' awards.[83] He further argues that judicial and legislative precedent militate against placing limits on the scope of arbitral authority.[84]

Another argument he raises is based on the freedom to contract. This parallel development, of latitude for arbitrators and narrow review for courts, is "consistent with the belief that by providing for arbitration, parties have voluntarily chosen a [final and binding] system of dispute resolution."[85] Further, the policy of allowing parties to choose their own forum originates in freedom to contract principles that cannot be disturbed by the courts.[86] The counterargument to this justification is fairly obvious, and is the principal thread running through all of these cases. It is inequitable to include in this binding agreement something a party did not consider — the possibility of paying or giving up the right to punitive damages.

E. Conclusion: Flaws in the Above Arguments

The courts and authors consistently avoid addressing rights of both the plaintiffs and defendants. Forcing defendants to pay punitive damages awards when they have not agreed to arbitrate the issue or forcing plaintiffs to forgo their punitive damage claims clearly advance some of the principal goals of arbitration — speed, efficiency, and low cost. But at what price? These courts fail to sustain arbitration as a legitimate and complete alternative to litigation. Raytheon, for example, would certainly have preferred a trial on the punitive damage issue, thus gaining some of litigation's judicial safeguards. Further, arbitration is part of a contractual agreement, which by definition, represents two parties attempting to finalize

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[81] *See* Stipanowich, *Punitive Damages*, *supra* note 55. This article is primarily a critique of the famous *Garrity* case, discussed *infra* text part V.A., that held that punitive damages are never awardable in arbitration.

[82] Stipanowich, *Punitive Damages*, *supra* note 55, at 981-82.

[83] *Id.* at 978.

[84] *Id.* at 982.

[85] *Id.* at 982-83 (citation omitted).

[86] *Id.* at 989 (quoting Sprinzen v. Nomberg, 389 N.E.2d 456, 459 (N.Y. 1979)).

their mutual understanding. It is thus inequitable to require parties to arbitrate something they either did not consider or specifically desired not to arbitrate. Finally, none of the above arguments address the fact that punitive damages in the commercial context can be viewed as a windfall. It seems unfair to require a commercial defendant to pay these sums without judicial protections. With these criticisms in mind, this Article turns to the other authors and cases that would not allow punitive damages in arbitration.

V. AGAINST ALLOWING PUNITIVE DAMAGES IN ARBITRATION

A. The Leading Case: Garrity v. Lyle Stuart, Inc.:[87] *Societal Norms Mandate That Only Courts Can Punish*

The *Garrity* decision has been discussed, analyzed and critiqued extensively.[88] It does, however, present some of the more persuasive reasons for not allowing arbitrators to reach the issue of punitive damages. In *Garrity*, the New York Court of Appeals held that enforcing a punitive damages award as a purely private remedy violated public policy and vacated an arbitrator's award of punitive damages.[89] Judge Breitel cited a number of principles in support of his holding.

First, "[i]t has always been held that punitive damages are not available for mere breach of contract for in such a case only a private wrong, and not a public right, is involved."[90] Contract law generally forbids the award of punitive damages in actions for breach; because arbitration is a contractual remedy, there is no place for punitive damages.[91]

Second, Judge Breitel wrote, even if the breach were sufficiently egregious to warrant punitive damages, "it was not the province of the arbitrators to do so. Punitive damages are reserved to the state, surely a

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[87] 353 N.E.2d 793 (N.Y. 1976).

[88] *See, e.g.*, Stipanowich, *Punitive Damages*, *supra* note 55; Shell, *Power to Punish*, *supra* note 8.

[89] *Garrity*, 353 N.E.2d at 795. One of the primary criticisms of this holding is Judge Breitel's lack of support for these public policy statements. *See* Stipanowich, *Punitive Damages*, *supra* note 55, at 961. Breitel stated that this holding applies even if the parties agreed to submit the punitive damage issues. This statement went beyond the scope of the case before the court. "The parties never agreed, or for that matter, even considered punitive damages." *Garrity*, 353 N.E.2d at 797.

[90] *Garrity*, 353 N.E.2d at 795 (citations omitted). *See also* United States Fid. & Guar. Co. v. DeFluiter, 456 N.E.2d 429, 432 (Ind. Ct. App. 1983) (disallowing a punitive damages award in arbitration "because parties may not contract to benefit from or be penalized by punitive damages").

[91] *Garrity*, 353 N.E.2d at 794.

public policy 'of such magnitude as to call for judicial intrusion.'"[92] The judge had several concerns with arbitrators invading the province of the state. He believed that arbitrators, unconstrained by substantive law, could render completely arbitrary punitive damages awards.[93] Breitel further argues:

> In imposing penal sanctions in private arrangements, a tradition of the rule of law in organized society is violated. One purpose [of the rule] . . . is to require that the use of coercion be controlled by the State. . . . The day is long past since barbaric man achieved redress by private punitive measures.[94]

Thus, Breitel argues, the freedom to contract does not include the freedom to punish.[95] This last assertion is questionable. No one would argue that all out-of-court settlements are purely compensatory. These settlements, accompanied by contract documents and disclaimers, are arguably private punishment, and receive even greater support as an alternative to litigation than does arbitration.

The *Garrity* opinion, while colorful, is the subject of much criticism. Judge Breitel did, however, address a legitimate concern: in the rush to expand the scope of arbitration, the rights of the defendant are often trampled.[96]

B. Criticizing Punitive Damages Generally and in Arbitration

Punitive damages are often criticized generally on a number of grounds. One of the strongest complaints is that punitive damages are a form of civil punishment.[97] Opponents of punitive damages argue that allowing punishment in a civil context, with its absence of the procedural safeguards found in a criminal trial, is a violation of due process.[98] Further, "the possibility of multiple jury awards against a single defendant . . . exacerbates the potential for the deprivation of property without due process

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[92] *Garrity*, 353 N.E.2d at 796 (citations omitted). This argument is seen in the due process discussion, *infra* text parts V.B-C.

[93] *Id.* (stating that this "would lead to a Shylock principle of doing business without a Portia-like escape from the vise of a logic foreign to arbitration law.").

[94] *Id.* at 796-97.

[95] *Id.* at 797.

[96] *See* the due process arguments, *infra* text part V.C.

[97] Margaret P. Sullivan, Comment, *The Scope of Modern Arbitral Awards*, 62 TUL. L. REV. 1113, 1125 (1988).

[98] *Id.* at 1125.

of law and raises the possibility of a double jeopardy violation."[99] Although the latter is less of a concern between business parties, the former is certainly relevant, given the limited procedural safeguards of arbitration.

Another general concern about punitive damages is the lower burden of proof in civil trials which distributes the possibility of error equally between the parties.[100] While this risk allocation is acceptable in a determination of compensatory damages, it is certainly more onerous when punitive damages are awarded. This too is exacerbated in arbitration because burdens of proof and other procedural safeguards are nonexistent.[101] One commentator notes that punitive damages in arbitration would eliminate one of arbitration's most attractive advantages.[102] As mentioned above, the growth of punitive damage awards by arbitrators will tend to invite greater judicial review.[103] Further, many parties that litigate are often involved in repeat transactions. Arbitration, with its less adversarial atmosphere, arguably helps enhance and protect these relationships. Punitive damages could encroach on this positive aspect.[104] Finally, if the procedural safeguards found in criminal or civil trials are instituted in an arbitration proceeding, the "resulting proceeding would be virtually indistinguishable from its litigation counterpart."[105] Thus, it would seem preferable to eliminate punitive damages from arbitration entirely. This solution, however, fails to address the rights of the aggrieved plaintiff. Any public policy bar to punitive damages in arbitration leaves a plaintiff without recourse to this remedy under *res judicata* principles.[106]

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[99] Sullivan, *supra* note 97, at 1125.

[100] *Id.* at 1125-26.

[101] *Id.* The Supreme Court addressed the issue of the constitutionality of large punitive damage awards repeatedly in the last several years and is concerned with the broad discretion found in jury trials. Although often sustaining the awards, the procedural safeguards the courts look to are clearly absent from arbitration. *See, e.g.*, Pacific Mutual Life Ins. Co. v. Haslip, 499 U.S. 1 (1990). The Supreme Court recently returned to this issue in TXO Production Corp., v. Alliance Resources Corp., 113 S.Ct. 2711 (1993). In multiple opinions the Court held against a due process challenge to a $10 million punitive damage award, where compensatory damages totaled only $19,000. One factor relevant to the decision was that "the notice component of the Due Process Clause is satisfied if prior law fairly indicated that a punitive damages award might be imposed in response to egregiously tortious conduct. Prior law . . . unquestionably did so." *Id.* at 2724 (citation omitted). *TXO* thus illustrates the importance of consistently notifying parties, who submit their claims to arbitration, of the potential award of punitive damages.

[102] Sullivan, *supra* note 97, at 1127.

[103] *Id.*

[104] *Id.*

[105] *Id.* at 1128.

[106] *Id.* at 1137. *See also* Rodgers Builders, Inc. v. McQueen, 331 S.E.2d 726 (N.C.

C. *Punitive Damages in Arbitration Violate Due Process Guarantees: Solution — Require a Written Finding*[107]

One author maintains, from a purely legal perspective, that punitive damages cannot be awarded in arbitration.[108] His primary argument is that punitive damage awards in commercial arbitration constitute state action, thus requiring due process.[109] Citing *Garrity*, he states that unlike traditional compensatory damages under contract, the power to award punitive damages is exclusively that of the state.[110]

An examination of the difference between compensatory and punitive damages is illustrative. Generally, claims for compensatory damages result from an interaction between autonomous parties gone awry.[111] These claims, because they are based on purely personal interaction, are removable from judicial administration. Punitive damages, however, use the breaching party's liability as a means of achieving the social goal of deterrence and punishment.[112] The availability of these damages has arguably been grafted onto the contractual relationship by the legislature or judiciary.[113] This distinction, taken one step further, leads to the conclusion that punitive damages must be imposed by the state, as it is outside of the parties' relationship.[114] Thus, the award of punitive damages is a state function.

The next stage in the author's analysis involves examining the process by which arbitrators award these damages[115] and applying the Supreme Court's due process balancing test.[116] The test analyzes three factors: First, the court examines "the private interest that will be impacted by the official action."[117] Clearly the private interest here is significant, as punitive damages awards can be quite large and bear little relationship to the actual damages suffered.[118] Second, the court must determine the possibility of

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1985).

[107] *See generally* Rothken, *supra* note 38.

[108] *Id.* at 403-04.

[109] Rothken, *supra* note 38, at 387.

[110] *Id.* at 394.

[111] *Id.* at 398.

[112] *Id.*

[113] *Id.*

[114] Rothken, *supra* note 38, at 398.

[115] *Id.* (Arguing the process is one of "unfettered discretion.").

[116] Mathews v. Eldridge, 424 U.S. 319 (1976). The test is used to determine "the constitutional adequacy of a particular set of procedures." Rothken, *supra* note 38, at 399.

[117] Rothken, *supra* note 38, at 399.

[118] This is true, except under statutes like MASS. GEN. LAWS ANN. ch. 93A § 52

erroneous deprivation of the private interest through these procedures and "the probable value of enhanced procedural safeguards."[119] Because arbitrators are bound neither by law nor fact, even if clearly erroneous, the possibility of error is quite high. Therefore, the probable value of safeguards is obvious. Finally, the court must examine the governmental interest, including the function involved and the various monetary and administrative costs incurred by improving the procedural requirements.[120] The government clearly has no legitimate interest in erroneous punitive damage awards, and the author argues that improving the procedural requirements by requiring a written finding is fairly simple.

The author argues that the uncertainty and secrecy of a punitive damage award and its related due process difficulties are easily remedied by requiring an arbitrator to prepare a written opinion justifying a punitive damage award, thus enabling judicial review.[121] Further, a quick and efficient arbitration process resulting in erroneous penalties would scare parties away from arbitration and would lead to greater litigation, precisely what arbitration seeks to avoid. Thus, the author concludes, as the matter currently stands, awarding punitive damages in arbitration violates due process.[122] Requiring a written finding, however, would rectify this situation.

The author fails to note that filing a written finding with any award of punitive damages presents additional benefits. First, a written opinion would improve the deterrent effect of punitive damage awards, especially if reviewed and sustained by a court, because it would become part of the public record. Second, it would give arbitrators some guidelines to follow when awarding future punitive damage awards. Finally, the procedure for reviewing a master's written findings on specific issues already exists in the Federal Rules of Civil Procedure.[123] On the other hand, requiring a written finding raises at least two difficulties. First, establishing judicial review involves legislative change of the standards found in the Uniform and Federal Arbitration Acts. Second, by opening up the review of arbitration, the parties are headed back in the direction of litigation.

(1994), where the compensatory damages are doubled or trebled. Regardless, the private interest is still significant.

[119] Rothken, *supra* note 38, at 399.

[120] *Id.*

[121] *Id.* at 401. The author fails to note that the UAA would require modification.

[122] *Id.* at 404.

[123] *See, e.g.*, FED. R. CIV. P. 53 and MASS. R. CIV. P. 53 (dealing with the appointment of Masters and the reviewability of their findings).

D. Raytheon *Was Wrong: Predefine Arbitral Authority*

Earlier, this Article discussed some of the rationales presented by the First Circuit in support of its decision in *Raytheon.*[124] This section presents a critique of that case, giving reasons why the court could have and should have held otherwise. Courts are currently interpreting arbitration clauses to "authorize awards of punitive, consequential, and liquidated damages, as well as injunctions and prejudgment interest."[125] One difficulty with this trend, and the *Raytheon* decision itself, is the practical issue of the parties' lack of awareness. One author points out that because broad arbitration clauses fail to specify that arbitrators may impose non-traditional contract remedies, the parties may not be aware that these agreements increase their exposure to potential liability.[126] Further, if were they are aware of their exposure, parties may still wish to avoid arbitration because it lacks judicial and procedural protection. These deficiencies lead to the conclusion that contracts containing broad arbitration clauses increase potential liability and eliminate procedural safeguards.[127]

One author's principal argument with the specific *Raytheon* decision is that the court should have required the arbitrators to predefine the scope of their authority.[128] He bases this argument in contract theory. Because arbitral authority is contractually created, the parties intent should control interpretation of their agreement.[129] The *Raytheon* contract contained a California choice-of-law provision. Under California law arbitrators cannot award punitive damages unless expressly authorized in the contract.[130] This demonstrates that the parties did not intend the arbitrators to consider punitive damages. The author argues that upon receiving Raytheon's written objection to punitive damages, the arbitrators should have immediately determined the scope of their authority under the contract.[131]

The author argues that the *Raytheon* court's distinction between labor arbitration, where punitive damages are not allowed, and commercial arbitration, where they are allowed, is not a valid one, because the policies behind punitive awards in commercial and labor arbitration are not

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[124] *See supra* notes 38–51 and accompanying text.

[125] Davis, *supra* note 26, at 696-97.

[126] *Id.* at 697.

[127] *Id.* at 698.

[128] *Id.* at 704.

[129] *Id.*

[130] Davis, *supra* note 26, at 704. This is based on the holding in *Belko,* discussed *supra* in note 50, and was distinguished by the *Raytheon* court.

[131] Davis, *supra* note 26, at 705.

contrary.[132] Further, the fundamental concern with subjecting the parties to punitive damages remains, regardless of the duration of the parties' relationship.[133] Thus, characterizing commercial arbitration as a "one-shot deal" resolves nothing and avoids the issue.

Finally, the author presents three arguments in favor of either requiring the arbitrators to predefine their authority or allowing punitive damages only where the arbitration clause specifically grants such relief. Requiring arbitrators to determine the scope of their authority prior to addressing substantive issues says Davis creates two advantages. First, it prevents the arbitrators from unauthorized expansion of their powers.[134] This in turn gives grounds for judicial review of the scope of this authority.[135]

The second advantage in requiring the arbitrators to predefine the scope of their authority is much more obvious. Parties, such as Raytheon, would not be taken by surprise. Having a better idea of their exposure to liability would encourage more informed decisionmaking about the desirability of arbitration.[136] Further, if the issue of punitive damages is within the scope of arbitration, both parties would be better prepared to present arguments and evidence in their favor.[137] Finally, by requiring parties to draft specifically tailored arbitration clauses, arbitration would remain an attractive alternative to litigation.[138]

Thus, the author addresses two important issues. First, he looks at defendants' rights, and concludes that under the current state of the law, defendants entering arbitration often get more than they bargained for and are left unprotected by the court.[139] Second, by arguing that arbitrators should predefine their authority, or in the alternative, that punitive damages be allowed only in the presence of a contractual agreement, the author presents a solution that does not significantly detract from any of arbitration's underlying benefits.

VI. CONCLUSIONS AND SOLUTIONS

Thus far, this Article has addressed the principal arguments in favor of

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[132] Davis, *supra* note 26, at 709.

[133] *Id.* at 709-10.

[134] *Id.* at 705.

[135] *See, e.g.*, MASS. GEN. LAWS ANN. ch. 251, § 12(a)(3) (1992). (The UAA allows judicial modification or vacation where an arbitrator ventures beyond the scope of the parties' agreement.).

[136] Davis, *supra* note 26, at 706.

[137] *Id.* at 707-08.

[138] *Id.* at 711.

[139] *Id.* at 710-11.

and against allowing punitive damages in arbitration. Those in favor argue that arbitration law permits minimal review, that arbitration must remain a flexible process, that the plaintiff must retain the right to recover punitive damages, and that significant precedent favoring arbitration prohibits crafting any more judicial exceptions. Those against argue that awarding punitive damages in arbitration is unfair to both parties, deprives them of due process, hurts the desirability of arbitration, and fails to recognize or address the parties' contractual expectations. They also argue that punitive damages are the province of the state because they are a form of punishment. Some of the suggestions for resolving this dispute include legislative change of the UAA, better tailored arbitration clauses, written findings by arbitrators on punitive damage issues, or a requirement that arbitrators to predefine the scope of their authority.

What are the other options? One could argue that these parties are bound by their contract. Let the courts of each state determine that state's rule and leave the parties to their bargain. Because arbitration is a voluntary process, this approach would certainly fail. One of arbitration's advantages is that most states and the federal government have enacted some form of the UAA. If each state develops a different rule on punitive damages in arbitration, not only would parties be less likely to consider arbitration a viable alternative, but also different rules would raise a host of conflict of law issues. Even if each state agreed to include punitive damages in arbitration, the due process issues are not addressed. Despite these problems, the principal goals of arbitration are speed, efficiency, and lessened expense. Notwithstanding current attempts to appeal arbitral awards of punitive damages, getting the judiciary overinvolved in the arbitration process is counterproductive. Combining the solutions presented above would allow punitive damage awards in arbitration and would recognize both parties' rights, while avoiding significant legislative or judicial action.

A. Notice and Written Findings

In the absence of a clear and specific arbitration agreement between the parties, each state or the AAA should establish the following procedure. First, arbitrators must establish the scope of the arbitration. For example, if the arbitrators are going to consider the issue of punitive damages, they should at least inform the parties at the very outset. This will avoid the patent inequity of the *Raytheon* result and narrow holdings like *Total Property*. Second, the arbitrators could be required to make a brief written finding of the amount of and justification for the punitive portion of the damages award. A clear and concise statement of the unfair, deceptive, fraudulent or other tortious conduct, and its relationship to the amount of

damages awarded would suffice. There would be no need for evidentiary analysis, discussions of the burden of proof, analysis of precedent, or other legal matters. Further, if the parties agreed that this written finding is reviewable, the UAA would not require modification.

By following these two simple procedures, arbitration could remain a speedy and efficient alternative to litigation. In addition, it would remove a degree of the randomness or unfairness currently found in the punitive damages in arbitration milieu.

B. Change the Standard Arbitration Clause

In the alternative, or in addition to, the above suggestion, by modifying the language of its standard arbitration clause, or of its rules, the AAA could avoid the entire issue. The following could be added at the end of the standard clause:

1. The parties DO AGREE — DO NOT AGREE (circle one) to submit claims to the arbitrator(s) for punitive damages arising out of the transactions that give rise to this arbitration.

2. If the parties DO NOT AGREE to submit the punitive damage claims, they preserve their right to present these claims in a court of law. Further, the parties agree that the arbitrator's decision is binding only as to the amount of compensatory damages or other nonpunitive relief awarded.

By inserting these two paragraphs, the parties either agree to submit their punitive damage claims, thus giving both sides fair notice, or agree to try the punitive claim in court. The second paragraph avoids the *res judicata* problems that preclude the relitigation of issues common to both the compensatory and punitive damage awards. In addition, the clause is fair to both plaintiff and defendant. The defendant will have either notice or a court's procedural guarantees, while the plaintiff will not be required to forgo a potential punitive damage claim. Although this would require a bifurcated proceeding, involving both arbitration and litigation, it is arguable that the stakes involved in a punitive damage suit merit the extra time and expense of waiting and preparing for a trial. It would also serve to minimize frivolous or "secondary" punitive damage claims. If a plaintiff felt that he had a poor case, he would not pursue the punitive damage claim in court.

It is unclear to this author, given the current split in authority and the vast amount of legal scholarship on the issue, why the AAA has not already changed the standard clause. This is particularly true given that the majority

of attorneys disapprove of punitive damages in arbitration.[140] Perhaps part of the reason is the paradoxical nature of the problem. On one side, everyone would like to be as fair as possible to both parties, while on the other, they would want to avoid slowing the pace or increasing the expense of the arbitration process. Yet, most of the suggestions offered to resolve the tension involve doing either one or the other, because as the procedural guarantees are strengthened, the process of arbitration becomes more cumbersome. The modification of the standard clause, however, is arguably a step in the right direction.

Finally, although the above solutions seem workable, significant input is needed from the legislatures around the country. Temporary measures are insufficient. The courts are presented with competing legislatively mandated processes — punitive damages and arbitration. The AAA or the legislatures, or both, must act if arbitration is to remain an attractive and viable option.[141]

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[140] *See* Stipanowich, *Rethinking*, *supra* note 22, at 467 (stating that in a survey conducted by the ABA, "[a]pproximately two-thirds of the survey group [of 503 attorneys] were opposed to amending the [AAA] Rules to expressly authorize arbitrators to award punitive damages").

[141] *Id.* at 485. "If public policy . . . ultimately require[s] that arbitrators be prevented from giving punitive damages, the answer must lie in statutory reform. . . ."